



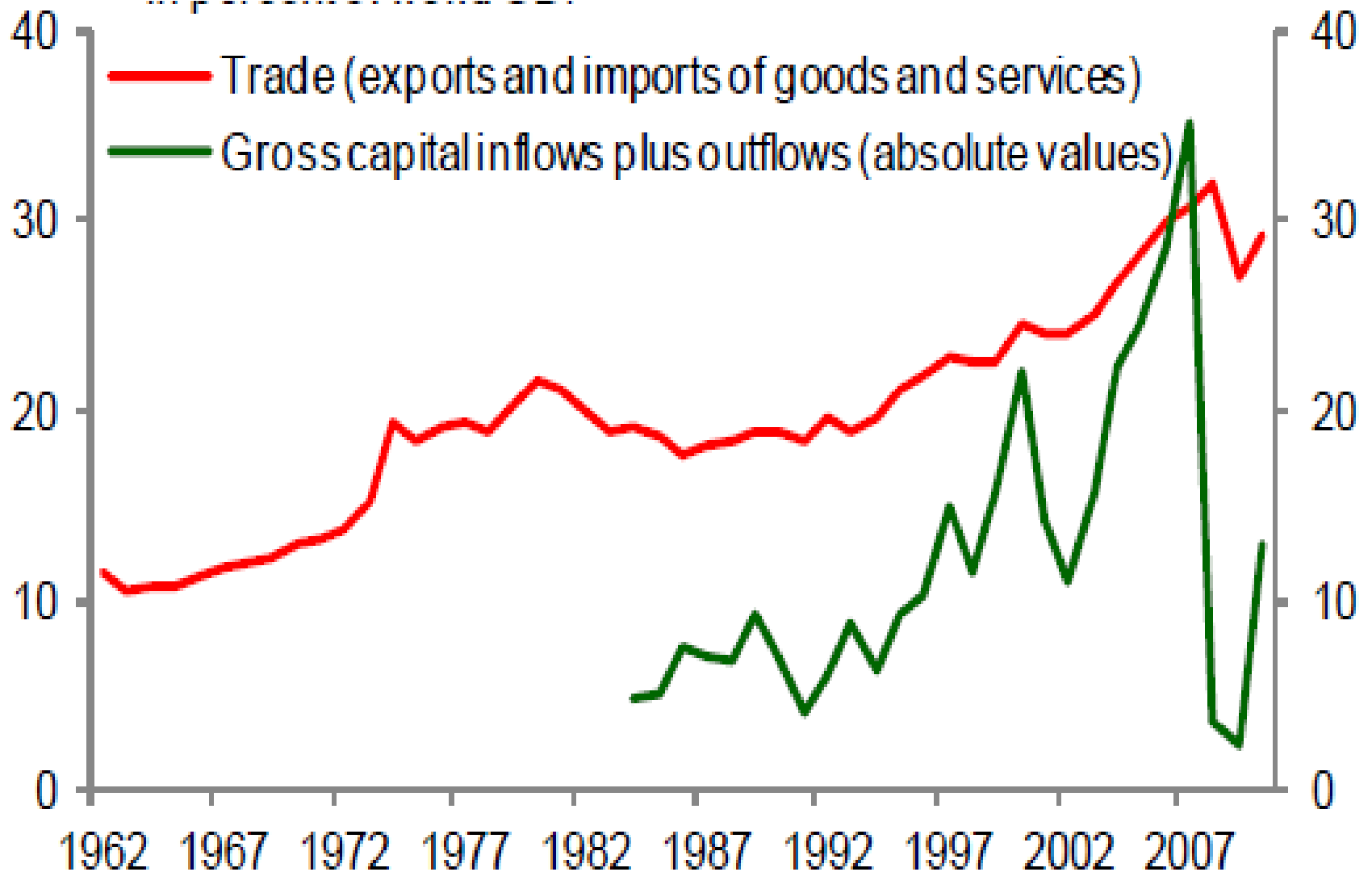
**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

**Monetary Policy, Capital Flows and Reform of the
International Monetary and Financial System**

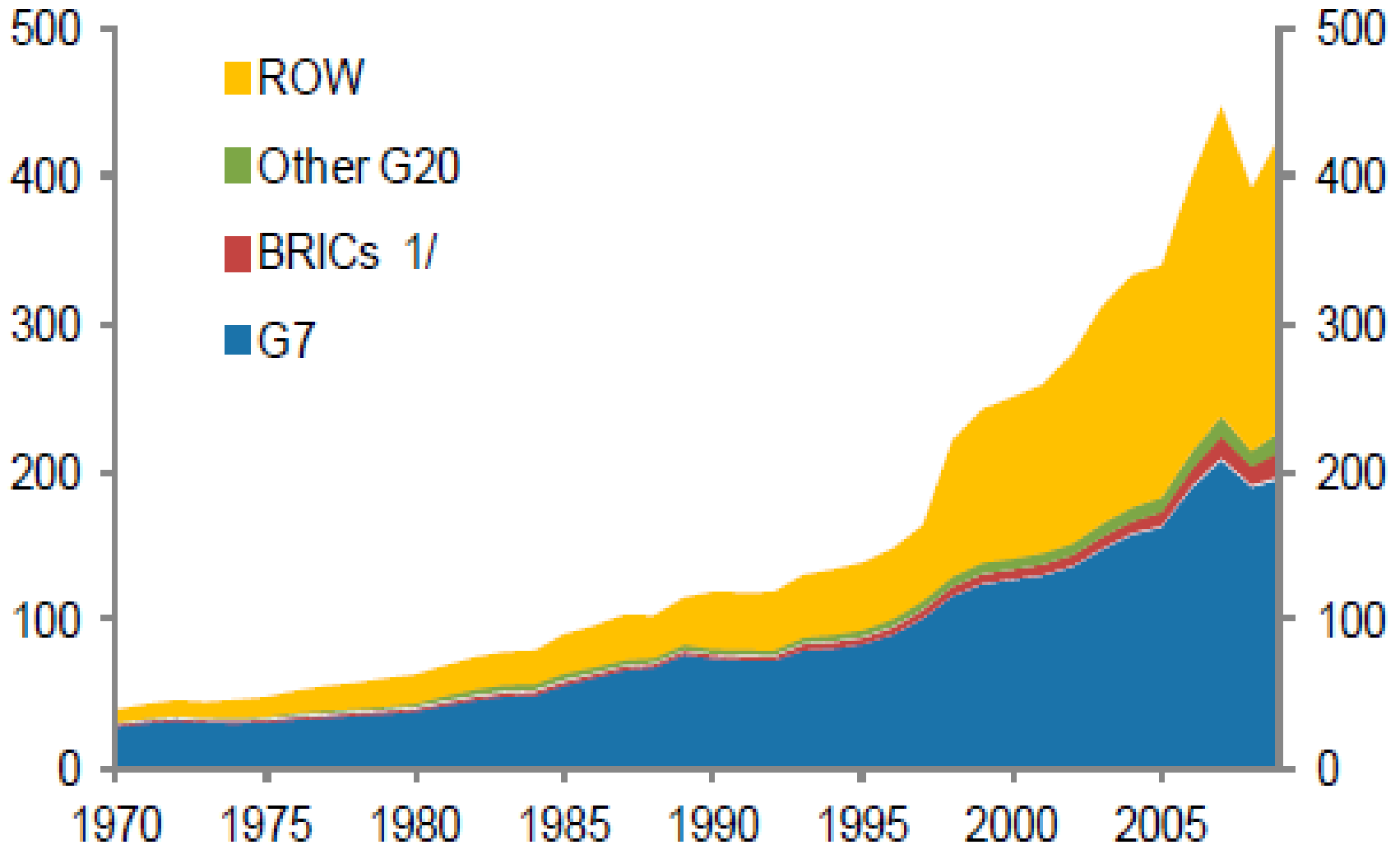
April 26, 2013

Skopje

Trade and capital flows in percent of World GDP



External assets plus liabilities in percent of world GDP



Independency of monetary policy

➤ Capital flows

- ✓ Excessive
- ✓ Volatile

➤ External stability

- ✓ Flow balances / management problem
 - Interest rate, currency and credit growth effects
- ✓ Stock balances / sustainability problem

Monetary policy and the IMFS

- The IMFS greatly affects monetary policies in reserve currency countries and other countries
- In EMEs monetary policy can not be confined to only macroeconomic stability in the presence of external stability

Outline

- The IMFS
- Monetary Policy
- Reform of the IMFS

Why is the IMFS important?

- The IMFS influences
 - ✓ Foreign trade of goods
 - ✓ The efficient allocation production factors among countries
 - ✓ International flow of financial funds
- The IMFS provides a framework for the international flow of goods, services, factors and financial funds in a stable way.

The IMFS

- The international monetary and financial system consists of
 - ✓ The International monetary system (IMS)
 - ✓ Global financial system (GFS)
- The IMS has evolved from inflexible system to flexible one:
 - ✓ The gold system
 - ✓ The Bretton Woods system
 - ✓ The current system

Phases of IMS

	Gold Standard 1870-1913	Bretton Woods 1945-1973	Current system From 1974
Free trade	Limited	Limited	Extensive
Labor mobility	High	Low	Low
Capital mobility	High	Low	High
Global institutions	Non-existent	Created	Lagging
National institutions	Heterogeneity	Heterogeneity	Standardization

Pros and cons of the IMFS

➤ Positives

- ✓ Strong growth in global GDP and world trade volume
- ✓ Integrated world in trade and finance

➤ Negatives

- ✓ Frequent external balances related financial crises
- ✓ Persistent CA imbalances and FX misalignment
- ✓ Volatile capital flows and currencies
- ✓ Excessive reserves accumulation

Objectives

- The IMFS should not impede internal macroeconomic stability
 - ✓ Independent monetary policy
- The IMFS should provide external stability
 - ✓ Allocative efficiency
 - ✓ External stability
- Impossible Trinity problem

Independent monetary policy

- Monetary policy separates between
 - ✓ Aggregate demand management
 - ✓ Liquidity management
- Monetary policy separates between
 - ✓ Home currency liquidity management
 - ✓ Foreign currency liquidity management

Unconventional monetary policy

➤ Separation I.

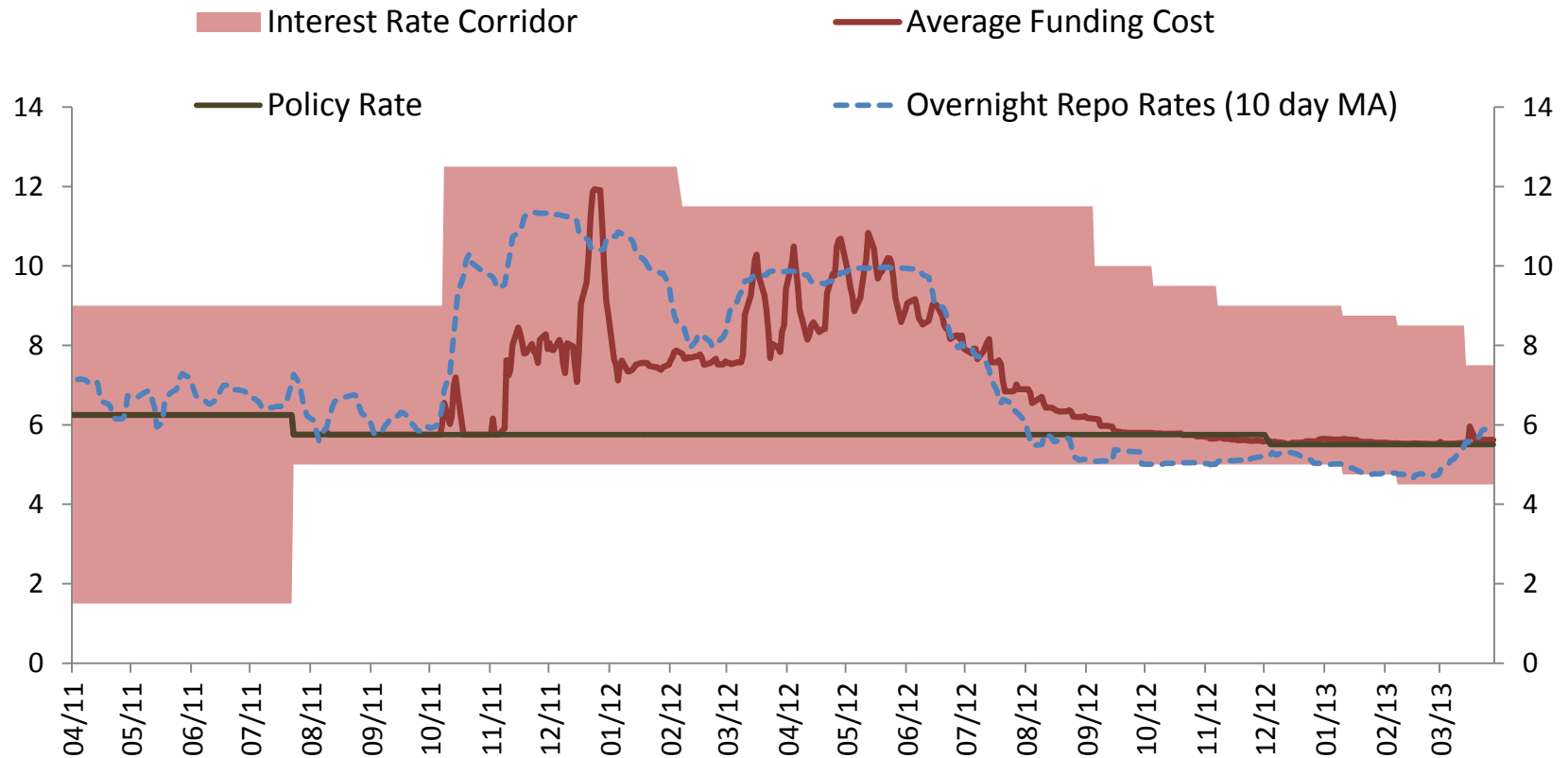
1. Rate on reserves and another rate
2. Interest rate corridor policy

➤ Separation II.

1. Official reserve accumulation policy
2. Private reserve accumulation system

Interest corridor policy in Turkey

Interest Rate Corridor, Average Funding Rate, and O/N Repo Rates in the Money Market (Percent)



Source: CBRT.

Last Observation: April 10, 2013.

Lending - Deposit Rate Spread



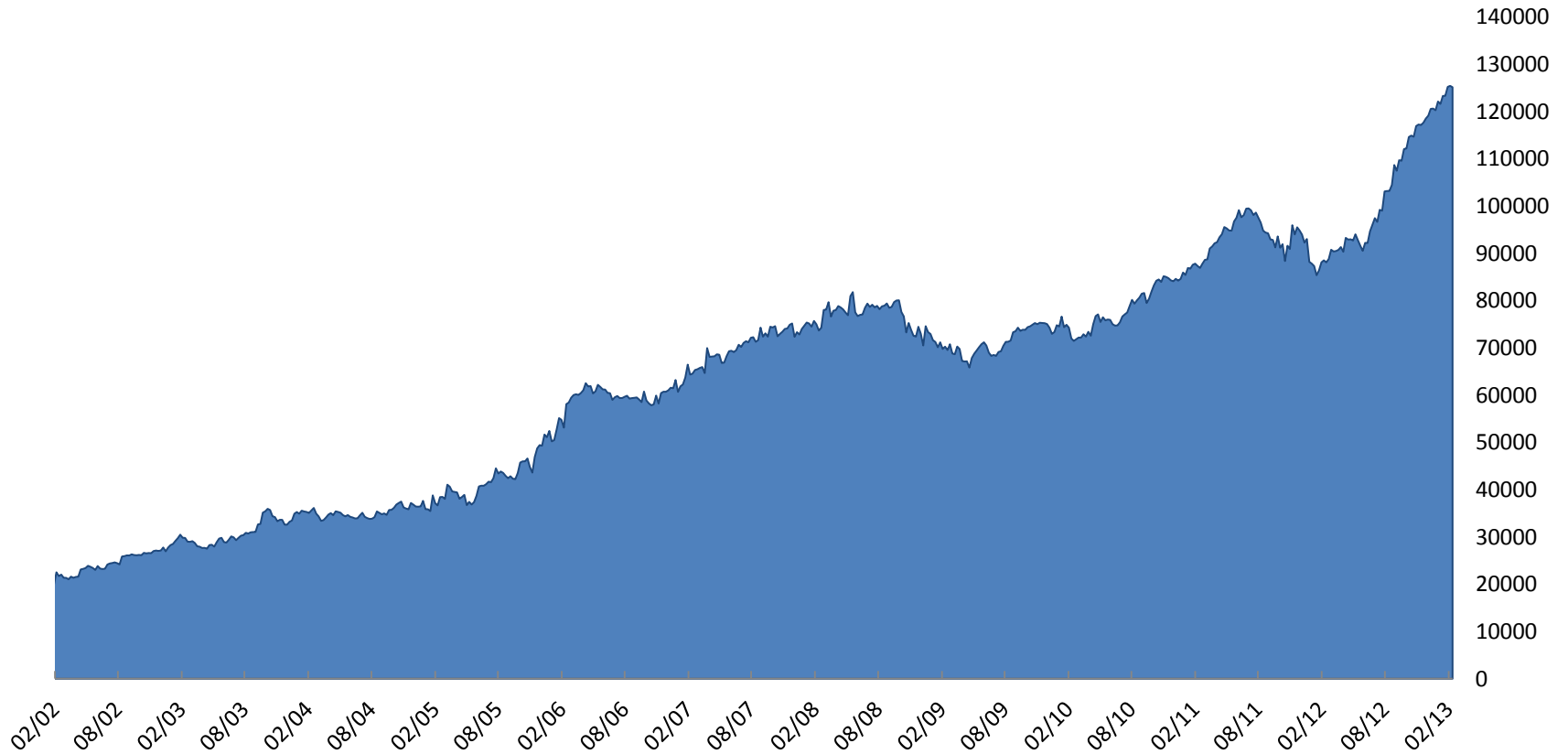
Source: CBRT.

Last Data: March 29, 2013.

4 Weeks MA

International reserves in Turkey

FX and Gold Reserves (Million USD)

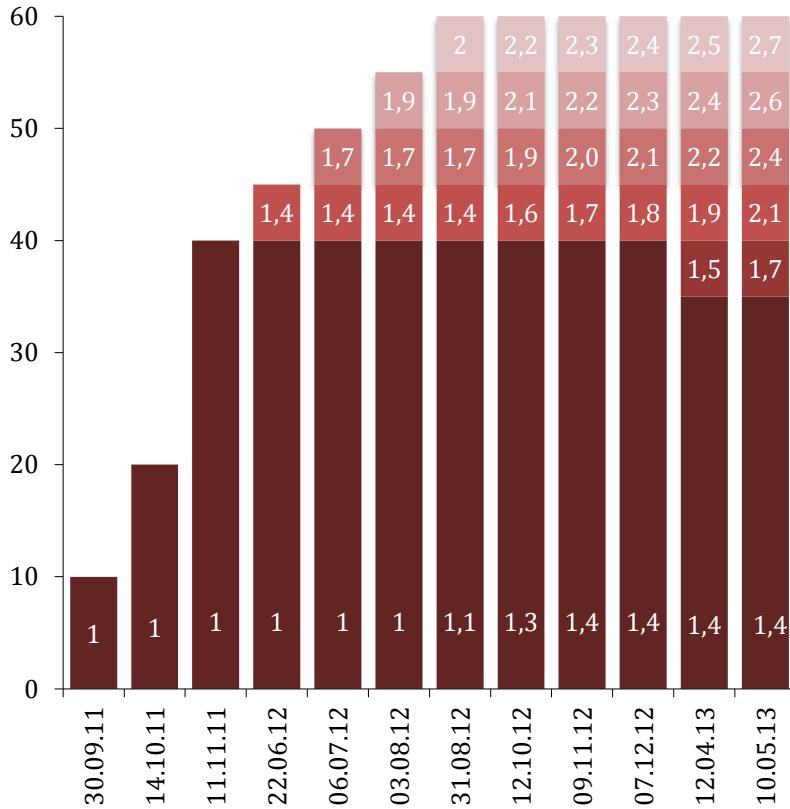


Source: CBRT

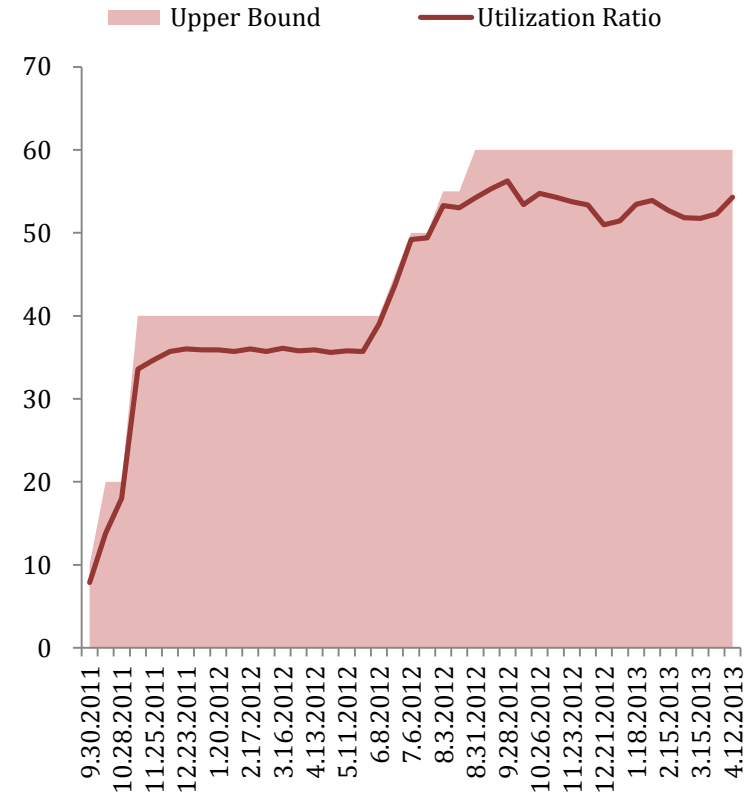
Last Observation: February 15, 2013

Reserve Options Mechanism (ROM)

ROC for FX*



Utilization of ROM (FX) (Percent)

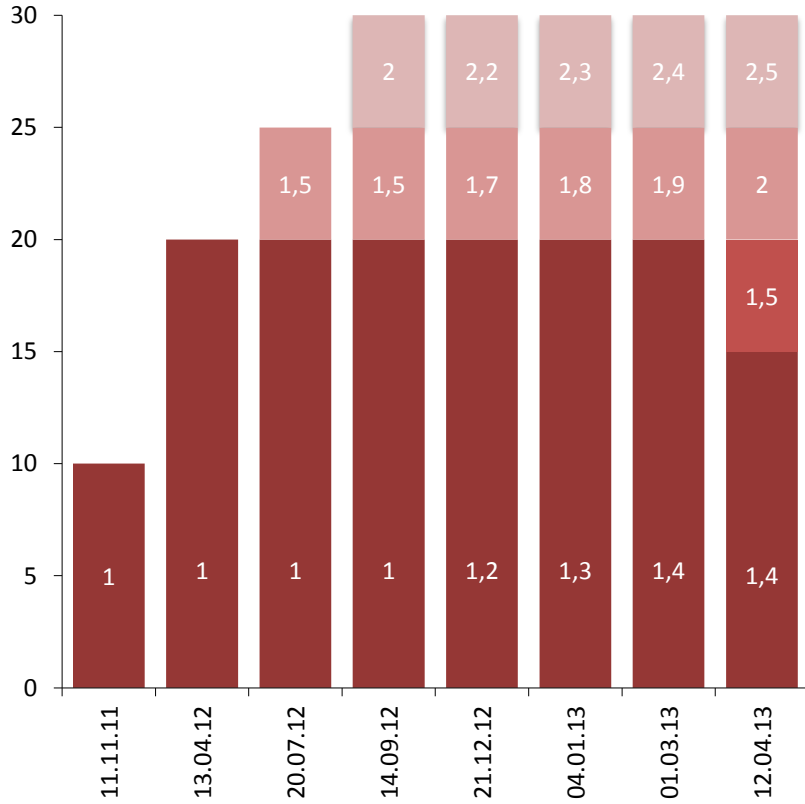


Source: CBRT.

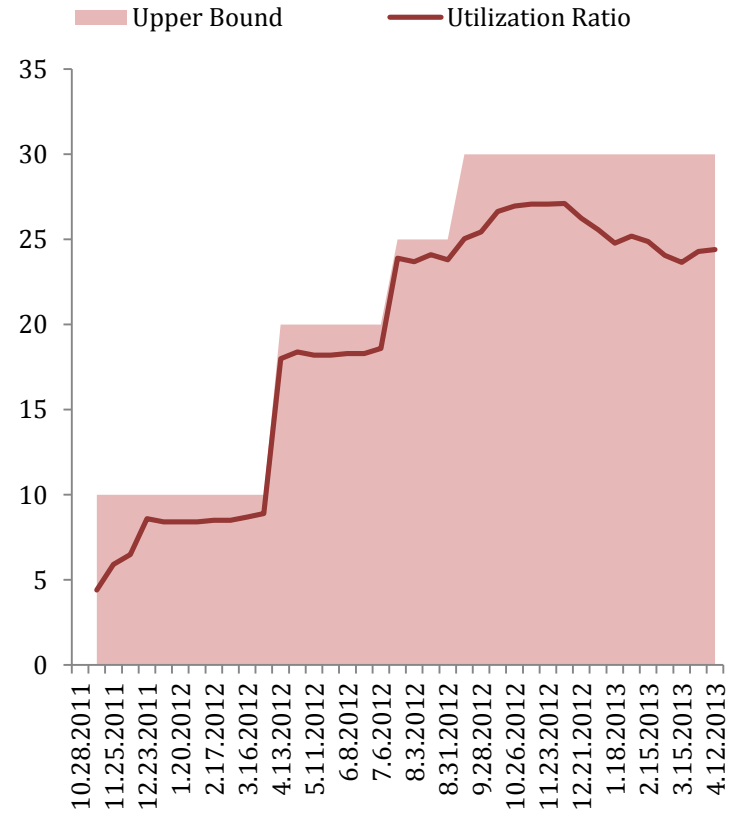
Source: CBRT. *In terms of holding periods.

ROM

ROC for Gold*



Utilization of ROM (Gold) (Percent)



Source: CBRT.

Source: CBRT. *In terms of holding periods.

Macroprudential policy

- Capital flow management often requires
 - ✓ Unconventional monetary policy
 - ✓ Macroprudential policy
- Impact on credit growth
 - ✓ More of macroprudential measures

Macro-prudential policies in Turkey

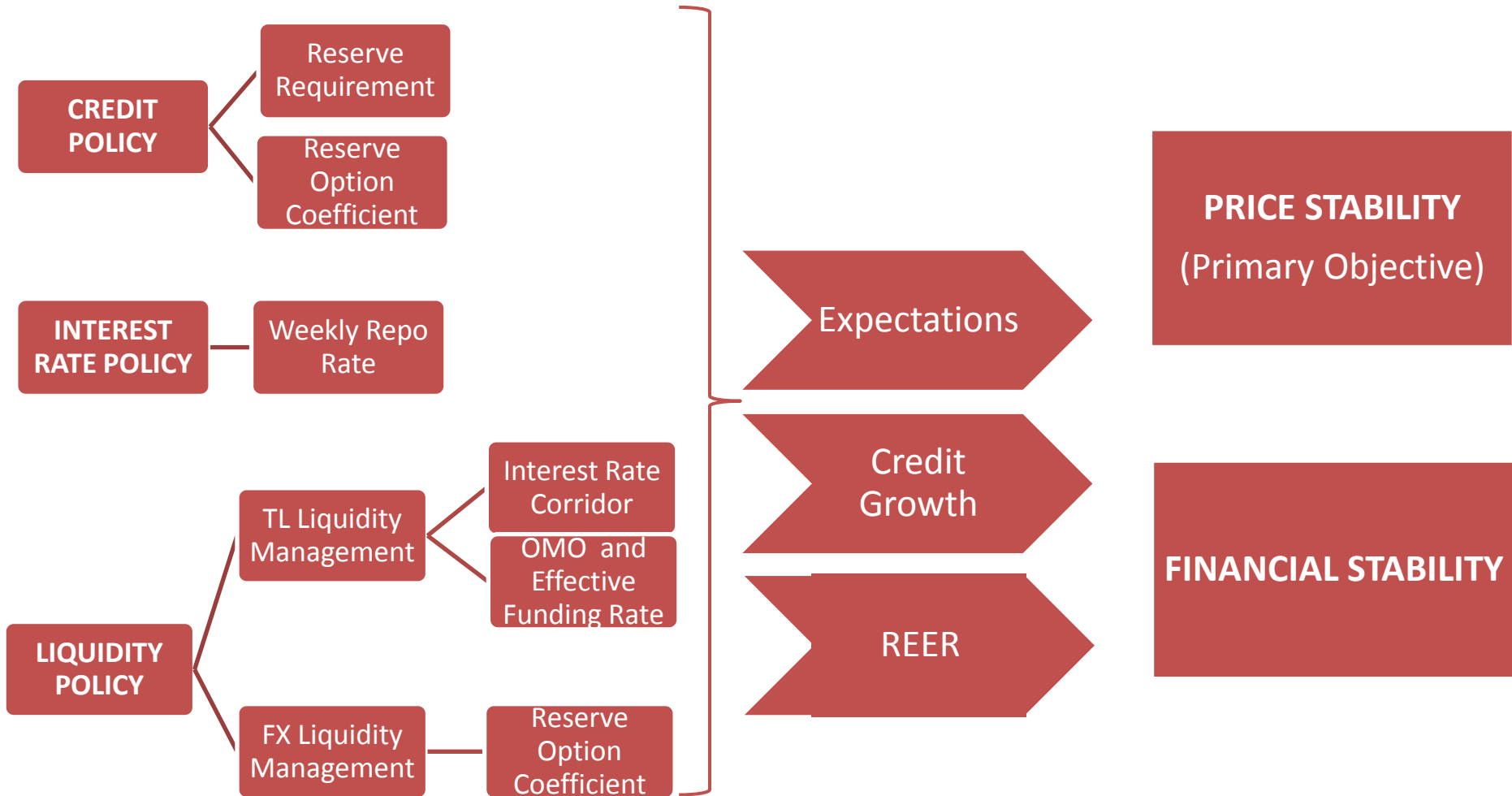
- Capital adequacy
 - ✓ dividend restriction policy
 - ✓ risk weighting policy – higher weights for consumer loans
 - ✓ capital charges on larger maturity mismatches
- Provisions – higher rate on consumer loans
- Lending policy
 - ✓ guidance on annual loan growth rate
 - ✓ limits to credit card payments
 - ✓ ban on consumer FX lending
- Reserve requirements
 - maturity related measures
 - leverage related measure
- LTV caps for residential and commercial property loans

Monetary and macro-prudential policies in Turkey

INSTRUMENTS

KEY INDICATORS

OBJECTIVES



The Basel III Reform

- Capital adequacy ratio
 - ✓ Countercyclical capital buffer
- Leverage ratio
- Liquidity ratio
 - ✓ Liquidity coverage ratio
 - ✓ Net stable funding ratio
- Net stable funding ratio is related to noncore liabilities which is ultimately determined by financial flows

The global financial system reform

- The Basel III reform
- Shadow banking
- SIFI framework
- OTC derivatives
- Data gaps
- Credit ratings
- Accounting standards

Implementation of the reform

- Timely adoption
- Consistency of regulation
- Consistency of supervision
- Transition effects (+deleveraging)
 - ✓ Treatment of exposure to EMDEs
 - ✓ Treatment of trade finance
 - ✓ Treatment of EMDE collateral
 - ✓ Ring-fencing international investment (Volker, Vickers and Liikanen)

The underlying imperfections of the IMFS

Markets related

I. Accumulation of external imbalances

✓ Pull factors:

- Financial market failure due to imperfect information frictions
 - Risk externalities, Regulation arbitrage, Procyclicality, Herd behavior, Excessive risk taking, Contagion

✓ Push factors:

- Underdeveloped financial markets in EMEs

Underdeveloped markets and related problems

➤ Underdeveloped financial markets

1. Local currency bond markets
2. Lack of hedging instruments
3. Inadequate insurance products

➤ Balance sheet problems

1. Maturity mismatch
2. Currency mismatch
3. Overreliance on debt finance

The underlying imperfections of the IMFS

Mechanism and framework related

- II. Inadequate adjustment mechanism
- III. Incomprehensive oversight framework

The underlying imperfections of the IMFS

Crisis resolution related

IV. Inadequate systemic liquidity provision mechanism

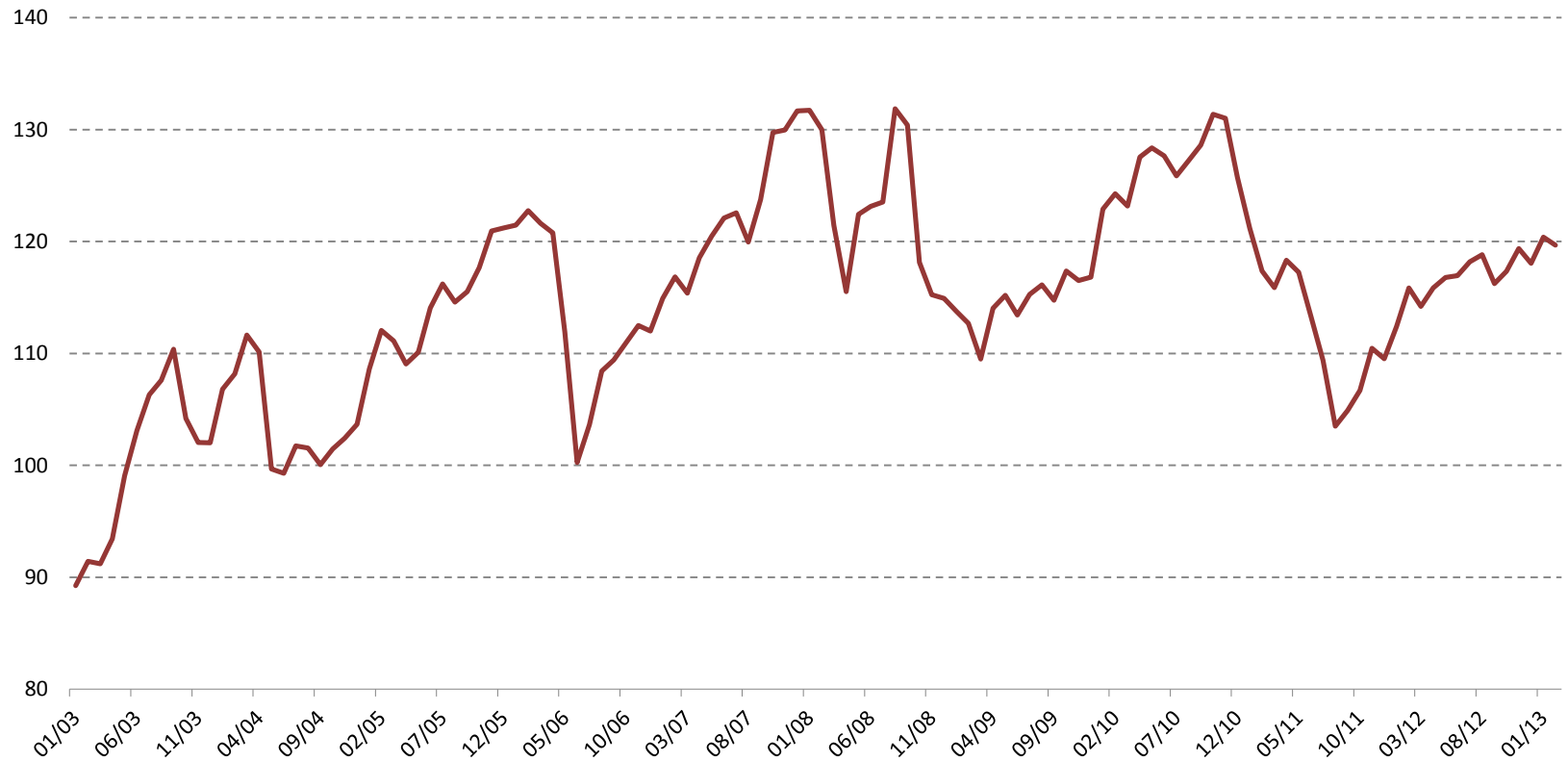
- Collective safety net
- Systemic liquidity net
- National safety net

Inadequate adjustment mechanism

- The current IMS: Impossible Trinity
 - ✓ exchange rate
 - ✓ capital account regime
 - ✓ domestic policies to domestic stability
- External stability via FX adjustment?
- Quantity adjustment
- Market discipline on deficit countries

Real effective exchange rate in Turkey

CPI based REER (2003 = 100)



Source: CBRT

Last Observation: February 2013

Structural challenges

- Role of the U.S. dollar
 - ✓ Reserve currency
 - ✓ Funding currency
 - ✓ Invoicing currency
- Global safe assets
- The changing “core”
 - ✓ Share of EMEs in the global economy is greater than that of AEs

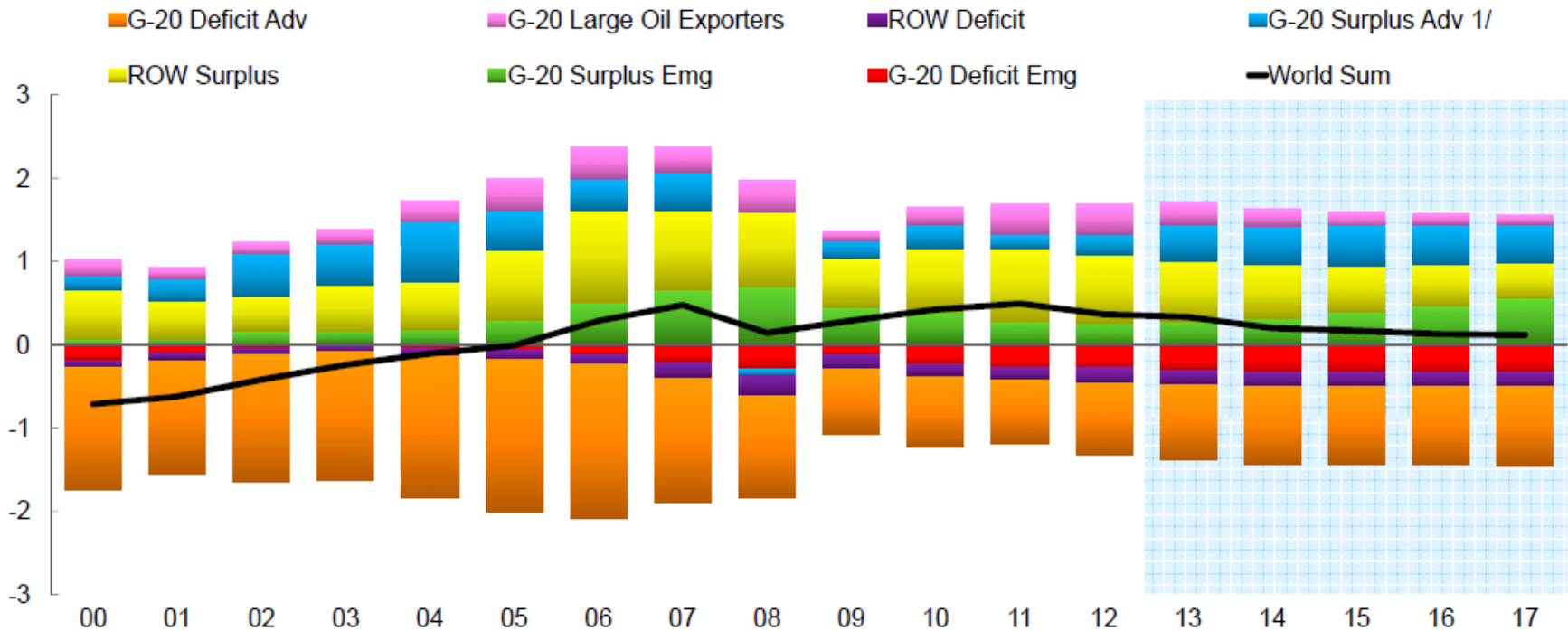
IMFS Reform

- Policy collaboration
- Management of capital
- Financial safety nets
- Financial deepening and currency internationalization
- Role of the SDR

Policy collaboration

Global Imbalances have Narrowed

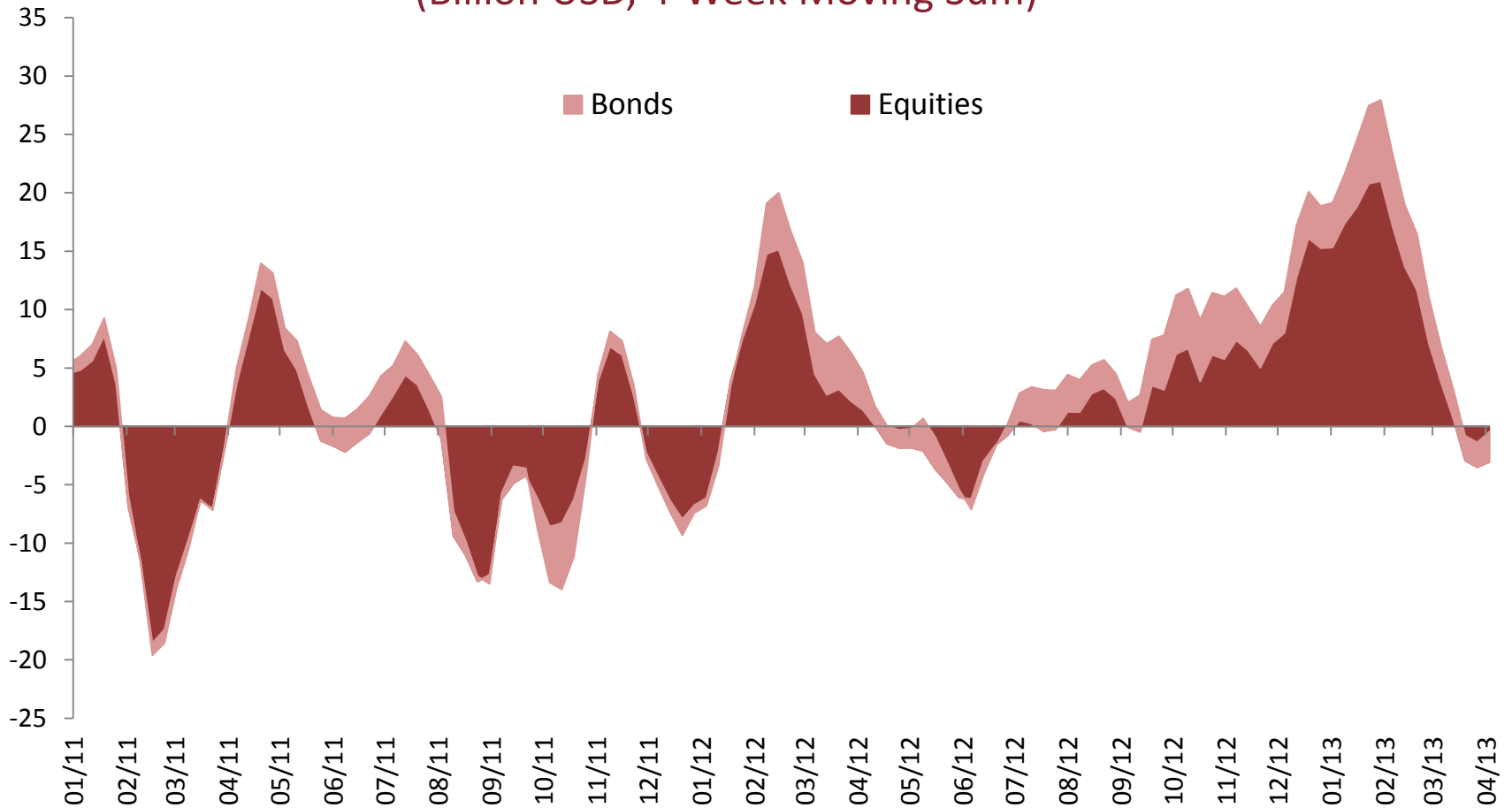
Current Account Balances
(percent of world GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
1/ Advanced surplus comprises Canada, euro area, Japan and Korea.

Volatile capital flows

Equity and Bond Flows to Emerging Markets (Billion USD, 4-Week Moving Sum)



Source: EPFR.

Last Observation: April 3, 2013.



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